What, Me Worry?

By Editor Test *Mon, Dec 17, 2012*

I can think of at least three easy ways to stay calm while investing in equities. Life's too short and too valuable to spend it checking stock movements on your iPad all day.

Last week I came across a remarkable quotation in a *Wall Street Journal* feature story on the agonies and ecstasies of owning equities.

"A 59-year-old plastic and reconstructive surgeon at the University of Chicago," the story said, "socks away money in mutual funds at [his advisor's] urging… Between surgeries, he consults his iPad a dozen times a day to check the stock market. Any sign of a big downturn, he said, would drive him out."

First, let me say that I wouldn't want my nose to be within range of this surgeon's rhinoplasty knife on a day the market tanked. Second, this story makes me question the quality of the advice he's getting. Third, his story reminds of three things I'd tell him if I were his advisor.

I'm not an advisor. But for several years I was employed by a large direct mutual fund company. Like all of my colleagues there, I spent 20-odd hours a year augmenting the firm's standing army of phone reps and fielding random calls from shareholders.

In this role I was part crisis-hot-line volunteer, part radio talk show host and part zero-fee investment advisor. (Or, perhaps, investment kibitzer.) The job was a rich source of anecdotal insight into investor attitudes. It also allowed me to share the ideas about investing that I'd absorbed from some of the smart people I worked for.

If the University of Chicago plastic surgeon were on the (recorded) line, I might say to him:

Invest in an inexpensive, all-purpose, set-it-and-forget-it mutual fund.

Take the Vanguard Star Fund, which costs only 34 basis points a year to own and offers a Whitman Sampler of investments. It's a classic balanced fund-of-funds with a 60% equity/40% bond/equity allocation. Its bond allocation comes in equal proportions from long-term investment grade, short-term investment grade, and GinnieMae bond funds.

Its stock allocation comes from Vanguard Windsor and Windsor II (14.2% and 7.8%), International Value and Growth (9.5% each), PRIMECAP (6.1%), Morgan Growth (6.1%), US Growth (6.1%) and Explorer, a well-known small-cap fund (3.8%).

Since its inception in 1985, the Star Fund has returned an average of 9.58% per year on a pre-tax basis. In the Great Recession of 2008-2009, it lost about one-third of its value, but $10,000 placed in the Fund in November 2002 would still have been worth $20,000 ten years later.

Why cling nervously to every word from Maria Bartiromo's lips when you can own a fund like this and focus on your fly-fishing skills instead? When you can implement the recommendations of unconflicted fund advisors and well-vetted sub-advisors for only 34 cents per $100 invested, why allow Jim Cramer to raise your blood pressure?

Don't risk more than twice as much as you can afford to lose.

At the craps table in Las Vegas or the roulette wheel at Mohegan Sun, you would be foolish to risk more than you could afford to lose. But you're not likely to lose more than 50% of your investments in equities. So you should be able to invest twice what you can afford to lose.

How much can you afford to lose? To figure that out, the 59-year-old surgeon might ask himself how much income he (and his spouse, perhaps) needs on top of Social Security and guaranteed pension income to fund a satisfactory retirement lifestyle.

If he needs $50,000, then he needs to know he'll have to be able to lay his hands on at least $1,000,000 when he retires. That's roughly the going price for a $50,000-a-year joint-and-survivor life annuity at age 65. If he has $1.2 million in assets, for instance, he can afford to put $400,000 of it in stocks.

Channel your inner bear.

We all know that market timing is a loser's game. But I was permanently impressed by a passage in Roger Lowenstein's excellent 1995 biography of Warren Buffett where he explains that Buffett was entirely in cash leading up to the crash of 1974-1975, when the DJIA dropped to 577. Buffett feasted on dirt-cheap blue chips; the rest is history.

Since reading that, I've wanted to become an investor who not only doesn't fear apocalyptic-seeming drops in equity prices but who recognizes them for the rare opportunities they are—and to be prepared to take advantage of them when they come.

The Great Recession of 2008-2009, which most people recall with dread, was one of those rare opportunities. The DJIA fell from a high of 14,164 to just 6,547. Triple-A corporate bond yields peaked at 6.28% and Baa bonds at 9.21%. Short-term panic by the masses created immense long-term profits for the few.

You don't believe such opportunities exist, except in hindsight? After my portfolio lost 35%, I rebalanced heavily into stocks and by late summer 2009 saw the wind refill my portfolio's sails. Did I master the art of market timing? Not really. In 2010 I moved cautiously back into bonds and have not enjoyed the rally since then as much as I might have. But that's fine. The important point is: I wasn't afraid.

In making these three recommendations, I don't pretend to offer definitive advice about investing. I'm not qualified to do so. But I feel that I'm as qualified as any other investor to share some tips on how to cultivate inner calm while investing in equities. The last thing I'd want to do with my time—which isn't as valuable as a plastic surgeon's—is to spend it checking the Dow Jones Average on my iPad twelve times a day.